RULE

Office of the Governor
Office of Financial Institutions

Banks
(LAC 10:III.701-703)

Under the authority of the Louisiana Banking Law, R.S. 6:1, et seq., and in accordance with provisions of the Administrative Procedure Act, R.S. 49:950 et seq., the Commissioner has adopted the following rule providing for Directors' Examination Requirements.

Title 10
FINANCIAL INSTITUTIONS, CONSUMER CREDIT, INVESTMENT SECURITIES, and UCC
PART III. Banks

Chapter 7. Directors' Examination Requirements

§701. General Provisions

A. Introduction. LSA-R.S. 6:290, 6:793, and 6:1310, amended by Act Number 530 of the 2001 Legislative Session, requires at least once in each year every state bank, savings bank, and savings and loan association (each hereafter referred to as "institution") to cause its books, records, and accounts to be examined in accordance with a regulation promulgated by the Commissioner of the Office of Financial Institutions. This examination is called the annual directors' examination and constitutes the institution's annual external audit program. The annual external audit program must be conducted in accordance with the requirements prescribed in this rule.

B. Board of directors responsibilities. The board of directors of an institution is responsible for determining how to best obtain reasonable assurance that the institution's financial statements and regulatory reports are prepared in accordance with appropriate accounting and regulatory standards. In this regard, the board is also responsible for ensuring that its annual external auditing program is appropriate based on the size and complexity of the institution and includes an evaluation of all significant risk. To help ensure the adequacy of internal controls and accuracy of financial reporting, the board of directors is required to establish and elect an audit committee of not less than three members, a majority of which should be outside directors.

C. Audit committee responsibilities. The audit committee shall secure and oversee the annual external audit program required by this rule. The committee shall require that a written report be presented to the board of directors and documented in the board minutes.

D. Scope. This rule does not apply to all institutions regulated by the office of financial institutions.

1. Institutions not subject to this rule include the following:
    a. Those institutions with total assets of $500 million or more. These institutions must comply with federal banking law annual external audit requirements, which are more stringent than the annual external audit options provided in this rule.
    b. Those institutions that have been insured by the Federal Deposit Insurance Corporation (FDIC) for a period of less than four years. These institutions are required to obtain annual financial audits performed by an independent public accountant.
    c. Those institutions that are under some type of enforcement action that requires an annual external audit program more stringent than the policy statement options.

2. Institutions subject to this rule include the following: (must meet all three criteria)
    a. Those institutions with less than $500 million in total assets at the beginning of their fiscal year, and
    b. Which have been insured by the Federal Deposit Insurance Corporation (FDIC) for more than three years, and
    c. Which are under no contractual or enforcement actions that would require an annual external audit program more stringent than the options contained in Subsection E of this rule.

E. Acceptable types of annual external audit programs. The types of annual external audit programs included in the Federal Regulatory Agencies' Interagency Policy Statement on External Auditing Programs of Banks and Savings Associations (Policy Statement) will meet the requirements of this rule. The Policy Statement provides for the following four types of annual external audit programs:

1. A financial statement audit performed by an independent public accountant;
2. A balance sheet audit performed by an independent public accountant;
3. A report by an independent public accountant on an institution's internal control structure over financial reporting;
4. An agreed-upon procedures or state-required examination report.

F. Auditor qualifications.

1. If an institution's audit committee secures any of the types of annual external audit programs listed in Subsection E (1) - (3), the annual external audit program, as well as reports issued, must be performed by independent public accountants that have experience with financial institution accounting and auditing or similar expertise, are knowledgeable about relevant laws and regulations, and comply with the accounting, auditing, and other professional standards referred to in the Policy Statement.

2. If an audit committee selects the type of annual external audit program listed in Subsection E (4), the annual external audit program, as well as reports issued, must be performed by either independent public accountants or qualified independent internal auditors. These individuals must have experience with financial institution accounting and auditing or similar expertise, be knowledgeable about relevant laws and regulations, and comply with the accounting, auditing, and other professional standards established for the professional designations they hold.

G. Annual reporting period. The annual external audit program shall cover a maximum of a twelve-month period of operations. Each subsequent annual report shall have the same ending period as the prior year report for comparison purposes, unless the institution obtains prior written permission from the commissioner to change its reporting date. The preferable time to schedule the performance of an annual external audit program is as of an institution's fiscal year-end. However, a quarter-end that coincides with a regulatory report date provides similar benefits. Therefore, an institution may choose either alternative as an acceptable reporting period for the annual external audit program, provided that same reporting date is used for future filings.

H. Due date and reporting requirements. Within one hundred twenty (120) days after the end of its fiscal year or quarter-end date that coincides with a regulatory report date for which the institution chooses as its annual reporting date, unless the institution obtains prior written permission from the commissioner to extend this date, each institution shall file with the commissioner two copies of the following:

1. The report, including all opinions and footnotes, if applicable, presented in connection with the type of annual external audit program selected by the audit committee and presented to the board of directors;
2. Any management letters issued by the individual or firm that conducted the annual external audit services, and
3. Management's response to any management letters issued.

I. Holding company subsidiaries. If an institution is owned by another entity such as a holding company and the group's consolidated financial statements for the same period are audited, the subsidiary institution is not required to obtain a separate audit of its financial statements provided the audit scope includes substantive testing of the subsidiary's financial records and activities. If the auditing firm considers the subsidiary institution's activities to be immaterial to the financial statements of the consolidated entity, the audit committee of the subsidiary institution shall obtain additional audit coverage that meets one of the four alternative annual external audit programs listed in Subsection E.

J. Due date and reporting requirements for consolidated financial statements. If an institution is included in an audited consolidated financial statement and the audit scope for the consolidated statement meets the requirements of Subsection I, within one hundred twenty (120) days after the end of its fiscal year or period for which the consolidated financial statements are presented, unless the institution obtains prior written permission from the commissioner to extend this date, the institution shall submit two copies of the following:

1. The consolidated audited financial statements, which shall include the accountant's report, financial statements, and all footnotes;
2. Consolidating worksheets for the balance sheet and statement of income that separately break out all entities within the consolidation on a separate basis;
3. Any management letters issued by the individual or firm that conducted the annual external audit services; and
4. Management's response to any management letters issued.

K. Multiple institutions included in a consolidated audited financial statement. If more than one institution is included in a consolidated audited financial statement, only two copies of the information listed in Subsection J should be submitted, with a cover letter identifying all institutions covered by the reports submitted. This information must be submitted to the commissioner of financial institutions within one hundred twenty (120) days after the end of the fiscal year or period for which the consolidated financial statements are presented, unless the institution obtains prior written permission from the commissioner to extend this date.

L. Requirements for a written engagement letter. The audit committee shall obtain a written engagement letter from an independent accountant or individual performing services, before such services are performed. The engagement letter shall include a description of all services to be performed, as well as any additional contractual conditions agreed to between the institution and the provider of the services.

M. Access to examination workpapers.

1. Management shall provide the independent public accountant or other individuals that perform the annual external audit program access to all examination reports and written communication between the institution and the federal agencies or state bank commissioner since the last annual external auditing activity.
2. All independent public accountants and independent internal auditors that perform any of the types of annual external audit programs listed in Subsection E shall agree in the engagement letter to grant all authorized state and federal examiners access to all workpapers and other materials pertaining to the institution, prepared in the course of performing the annual external audit program.

§ 702. Definitions

Agreed-upon procedures/State required examination report- the fourth type of annual external audit program allowable under the Federal Regulatory Agencies' Interagency Policy Statement on External Auditing Programs of Banks and Savings Associations. If an audit committee chooses this type of annual external audit program, the audit program must be performed in compliance with a policy statement issued by the commissioner.

Annual Directors' Examination - an annual examination of an institution's books, records, and accounts that must be --

1. the responsibility of and performed under the direction of the audit committee of the board of directors,
2. one of the types of audit programs permitted in this rule,
3. performed by individuals that meet the requirements stated in this rule,
4. summarized in a written report that is presented to the board of directors, and
5. submitted to the Commissioner of the Office of Financial Institutions and the FDIC, along with copies of management letters and management's response, within the time frames established in this rule.

Federal Regulatory Agencies- The Board of Governors of the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), and the Office of Thrift Supervision (OTS). These agencies cooperatively issue interagency policy statements.

Immediate family members - an individual's spouse, minor children and any children, including adult children, residing in the individual's home.

Independent internal auditor-a qualified internal auditor that is, in fact, independent as defined in the Standards for the Professional Practice of Internal Auditing by the Institute of Internal Auditors and/or the Statements of Principle and Standards for Internal Auditing in the Banking Industry by the Bank Administration Institute.

1. An internal auditor will not be considered independent if, for example:
   a. he/she is employed by or accountable to anyone other than the board of directors of the institution or holding company, if applicable;
   b. his/her performance is evaluated by and salary and annual bonus are set by anyone other than the board of directors of the institution, or holding company if applicable;
   c. his/her duties consist of non-audit responsibilities within the institution or holding company;
   d. he/she has any proprietary interest in any partnership, firm or corporation which controls the institution, directly or indirectly, except that he or she may own and/or have a beneficial interest (including any shares of a retirement and/or incentive plan) of up to a maximum of one percent of the total outstanding shares of the institution or holding company which employs the internal auditor;
   e. he/she has any loan (including any overdrafts, cash items, unposted items, drawing against uncollected funds, or any other such items) to or from the institution or holding company or any officer, director, or principal stockholder thereof. This latter prescription does not apply to the following loans from a financial institution, if they are free from classification by bank regulatory authorities and made under normal lending procedures, terms and requirements:
      i. automobile loans and leases collateralized by the automobile;
      ii. loans secured by the surrender value of an insurance policy;
      iii. loans fully collateralized by cash deposits at the same institution;

iv. credit cards and cash advances on checking accounts with an aggregate unpaid balance of $5,000 or less, provided that these are obtained from a financial institution under its normal lending procedures, terms, and requirements and are at all times kept current as to all terms.

f. he/she is a member of the immediate family of an officer, director, attorney, or employee of the institution or holding company.

2. The aforementioned examples are not to be construed as all-inclusive criteria in judging the independence of an internal auditor, as other conditions may also contribute to the lack of independence. It is the responsibility of the board of directors to determine if there are any unusual relationships or affiliations, which the internal auditor may have with the institution and to have any questions as to his or her independence resolved before he or she proceeds with the examination. Any unusual relationships shall be disclosed to the Commissioner of the Office of Financial Institutions.

Independent Public Accountant- an accountant who is independent of the institution and registered or licensed to practice, and holds himself or herself out as a public accountant, and who is in good standing under the laws of the state or political subdivision of the United States in which the home office of the institution is located. The independent public accountant must comply with the American Institute of Certified Public Accountants' (AICPA) Code of Professional Conduct and any related guidance adopted by the Independence Standards Board and the agencies. No certified public accountant or public accountant will be recognized as independent if he/she is not independent both in fact and in appearance.

Outside director - members of an institution's board of directors who

1. are not officers, employees, or principal stockholders (as defined below) of the institution, its subsidiaries, or its affiliates, or
2. are not immediate family members of officers, employees, principal stockholders of the institution, its subsidiaries, or its affiliates, or
3. do not have any material business dealings with the institution, its subsidiaries, or its affiliates.

Policy Statement-The Interagency Policy Statement on External Auditing Programs of Banks and Savings Associations issued by the Federal Regulatory Agencies.

Principal stockholder - Any person that, directly or indirectly or acting through or in concert with one or more persons, owns, controls, or has the authority to vote more than twenty percent (20%) of any class of voting securities of the financial institution or its parent company. Voting securities owned or controlled by a member of a person's immediate family are considered held by that person.

Q*ualified independent internal auditor*- An internal auditor that meets the "independent internal auditor" definition in this subsection who is a duly registered certified public accountant in good standing under the laws of this state, a certified internal auditor, a chartered bank auditor, or an individual that has functioned as an internal auditor in financial institutions for a minimum period of two years that recognizes and adheres to the rules of conduct and personal standards established for the professional designation(s) he or she holds. Any certified public accountant functioning as an internal auditor must adhere to the rules of conduct and standards applicable to the CPA in practice.

AUTHORITY NOTE: Promulgated in accordance with R.S. 6:290, 6:793 and 6:1310.
HISTORICAL NOTE: Promulgated by the Office of Financial Institutions, LR. 28

If any provisions or item of this regulation, or the application thereof, is held invalid, such invalidity shall not affect other provisions, items, or applications of the regulation which can be given effect without the invalid provisions, item, or application.

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